A PERCEPTION ANALYSIS OF CUSTOMER'S SENSITIVITY TO INTEREST FACTOR IN CONTEMPORARY ISLAMIC BANKING IN PAKISTAN

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ABSTRACT:

This study aims to understand common customer's perception about interest factor in Islamic banking in Pakistan. Initiation of Islamic banking has produced numerous issues for banking sector in Pakistan. Based on theoretical background, research questions and objectives were developed which were investigated through a survey type study. This endeavor revolves around a two-fold enquiry. First it probes the perception of customers about current practices and products offered by Islamic banks. Secondly it considers the awareness level of customers, based on real knowledge. Data was collected from selected respondents having their bank accounts in either conventional or Islamic banks. In addition to cross tabulation, Analysis of Variance and Regression were used to analyze the data. The result of the study indicates that customer have almost the same perception about interest factor in Islamic banks as in other conventional banks. Moreover, besides other factors the findings show that awareness has a significant role in this perception.

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1. Introduction

This study aims at understanding the perception of general public about interest factor in Islamic banking in Pakistan. Banking serves as most powerful capital mobilization tool of the modern financial structure of the economy. Wilson (1979) advocates that it facilitates the flow of monetary resources to promising sectors for wealth creation and employment growth. Currently, banking industry is perceived to be mainly divided between Islamic and conventional mode[1]. Conventional banking stands on foundation of interest-based transactions and handling of funds while Islamic one repudiates itself from dealing in interest.

History of banking is deep-rooted in practices of deposits of money and gold for safe custody with Jewish businessmen in the 7th century. Indian subcontinent witnessed banking inception in 18th century with the establishment of bank of Hindustan. After some time, it was followed by establishment of General Bank of India[2]. Pakistan inherited the banking practices since independence in 1947.Banks perform a fundamental function in mobilizing capital and making them available to finance viable projects. They obtain deposits from the savers and grant loans to public and private fund managers to boost new ventures. Such movement of wealth is unavoidable to create strong economy. Banks act as intermediary between excess and shortage units to encourage economic activities[3].

[1] Faruq and Kabir, "Regulation and Performance of Islamic Banking in Bangladesh."
[2] Wikipedia contributors, "Banking in India."
[3] Khattak, "Customer Satisfaction and Awareness of Islamic Banking System in Pakistan."

Hence, Contemporary banking services consist of diverse financial products and service offerings. These on one hand include basic services of deposits, advances and profit while on the other hand they also specialize in wire transfer, facilitation of international trade, investment, lease and insurance services[4].

Primarily the banking system is interest-based but has a global popularity for money circulation and financial transactions. Tahir and Muhammad (2008) are of the view that although all the countries know about these banks that these banks are based on interest, but still there was no source who could present an alternate viable system serving all underlying sectors. It was the mid of previous century when Muslim thinkers thought about this problem. Based on their thinking, the first Islamic bank came into existence in Pakistan as Meezan bank in the year 2002[5]. This bank is pure Islamic bank and based on *ṣḥārī̄āḥ* laws. At present two types of banking systems prevail in the country i.e. "Islamic banking" and "Conventional Banking". A considerable difference of two systems is of objectives[6]. Islamic banking has major objectives of *ṣḥārī̄āḥ* compliance. It means instilling divine guidance into present financial structure of trade and transactions. It discourages wealth maximization as the only objective of one's entire business efforts. Though Islam does not totally discourage profit motive and private ownership of resources. Conventional banking links itself as only the intermediary, facilitating flow of capital from provider to the needy with no regards to the nature

[4] Woelfel, "The Handbook of Bank Accounting."
[5] Usmani, "Present Financial Crisis, Causes and Remedies from Islamic Perspective."
[6] Akhtar, "Building Inclusive Financial System in Pakistan."

and operation of business[7]. Conventional banking charges a fixed return for its services and promises same to fund provider with practically no interference in actual level of profit/losses of business[8]. Additionally, Islamic banking entered the arena with objective of sharing ultimate results of a proposed business intervention.

1.1 Perception and its Significance

Perception is defined in various disciplinary and interdisciplinary understandings. In Sum, it is general sense making of the world around us [9]. Human perception is a complex process and as unique as an individual self. An in-depth study provides various interesting facets of perception that play crucial role in giving meanings to social phenomena and settings. It includes perceptual selection, bridling, halo and horn effects and stereotyping. In social science research, perception has a great deal to do with human understandings and interpretations of social phenomena[10]. It is ubiquitously applicable to both qualitative and quantitative investigation. The coordinates of perceived social premises may not be congruent with reality. In case of current study, the customers' perceptions are to be studied regardless of the real application of sharia law in banking practices. This would attempt to help understand the Islamic banking scenario with pure customer's perspective.

Different researchers have different views about Islamic banking and its operations. Some of the researchers perceive profit factor in Islamic

[7] Usmani, "Interest Free Banking (URDU: Ghair Soodi Bankari)."
[8] Naqvi, *Ethics and Economics: An Islamic Synthesis*.
[9] Buchanan and Bryman, "The Organizational Research Context: Properties and Implications."
[10] Rollinson, *Organisational Behaviour and Analysis: An Integrated Approach*.

banking is an interest like that in conventional banks[11]. While some of the researchers perceive Islamic banking is free of interest. This research has worked on knowing the customer's perception about interest factor in Islamic banking in Pakistan. Based on above facts, the primary questions that this study will answer are:

1. What is the customer's perception about interest factor in Islamic banking in Pakistan?
2. What is the awareness level of customers about interest free banking in Pakistan?

2. Literature Review

2.1 Banking System in Pakistan

In undivided India Muslims as a community were reluctant to openly participate in banking activities. They had no option to keep huge cash funds of their businesses and obtain financing for expansions except existing interest based banking entities[12]. Habib bank was founded to have an avenue of though conventional banking practices but to be more attractive for Muslim identity. After independence, the inception of Muslim commercial Bank was a similar step. These were just confidence building measures having a psychological appeal but with no actual guidance from ṣḥārīāḥ compliance or fīqā insights.

The current picture of banking industry in Pakistan is glowing one and poses this sector with enormous growth in last couple of decades. State bank of Pakistan has regulatory authority of all operating commercial

[11] Sirageldin and Anwar, "Islam, Society, and Economic Policy [with Comments]."
[12] Abdul Rahman and Dean, "Challenges and Solutions in Islamic Microfinance."

banks in both public and private sectors. Total number of scheduled banks is 34 [13]. Of them 5 operate as public sector, 16 as private, 4 as specialized and 13 as Islamic banks. Some banks like Habib bank and Khyber bank have dual representation as both conventional and Islamic. There are 6 foreign banking organizations contributing their services.

2.2 Overview of Islamic Banking

Islamic financial system not only discourages interest but also businesses whose conduct or subject matter is considered prohibited (*haram*) in Islam. Therefore gamble, liquor, pork, pornography and human trafficking cannot be financed through Islamic modes[14]. Later half of previous century witnessed serous academic and research efforts to eliminate *Rībā* from prevailing financial systems. First such experiment was performed in Egypt in 1963 where a banking entity operating on profit and loss basis was founded. Credit goes to Dr. Ahamd El Najjar, who initiated the idea of *Mitghamar* bank without prefix of "Islam". Naqvi (1981) maintains that it met success and others follow suit and nine other such entities came into being in following decade.

His sincere efforts made it possible to lay foundation of The Nassir Social Bank, in Egypt in l97l, as an interest free commercial banking unit. In the following decade, several banks, operating on same footings came into being in the Middle East, such as, "Dubai Islamic Bank" (l975), "Faisal Islamic Bank of Sudan" (l977), "Faisal Islamic Bank of Egypt" (l977), and the "Bahrain Islamic Bank" (l979). The wave got a boost when an epic

[13] Contributors, "List of Banks in Pakistan."
[14] El-Gamal, "Interest and the Paradox of Contemporary Islamic Law and Finance."

institution- the Organization of Islamic Countries (OIC) promoted "Islamic Development Bank" in l974[15]. Over the last three decades, Islamic banking experienced a whopping success and has evolved into complete banking system. According to Islamic Banking Bulletin of State Bank of Pakistan (2017), the growth rate of Islamic bank is 15% per annum which is heartening for the managers of a new financial practice. It also reveals that a promising future awaits Islamic banks and those who plan to enter the arena.

Presently there are about 270 Islamic financial institutions in seventy-five countries of the world with estimated assets of more than US$265 billion. The volume of financial investments so far accrued is estimated above US$400 billion. Islamic financial institutions are operating in Muslim as well as European countries, US and Far East.

2.3 Research Perspectives on Islamic Banking

According to Pollard and Samers (2007) interest in business is forbidden in Islam. Islam encourages for business operated on mechanism of profit sharing ratio instead of interest. Islam puts a stop to make in trades that involve "narcotic" and "betting".

Lim and Razzaque (1997) stated that Muslims depositors enjoy the profits of Islamic banks and they thought that their savings are free of interest. It is also realized that Islamic banks do not practice those activities which are against Ṣḥāḥrīā[16]. Hassan et al (2012) argue that perceptions of customers of Islamic mode of financial transactions are of

[15] Usmani, *An Introduction to Islamic Finance*.
[16] Ahmad, "Islamic Finance and Banking: The Challenge and Prospects."

significant academic and practical value. Their study conducted in similar geographical premises contribute that customers consider that the main difference between the "Islamic banking" and "conventional banking" is interest, which is not permitted in Islam. Islamic banking is based on Shariah law whereas conventional banking is based on profit (interest) maximization[17]. Conventional banks earn from interest while Islamic banks adopt alternative methods administered under Ṣḥārīāḥ i.e. partnership, mutual solidarity to earn profit. The rules are different in both "Islamic" and "Conventional". Granting of interest known as "Rībā" is strictly forbidden in Islamic Banking[18].

As the banking system is distributed in Islamic and conventional banking system in the twentieth century but still the Islamic banking system is criticized for their performance. With ever increasing market demand, many conventional banks in region are now opting Islamic banking practices. It is evident from "Islamic Windows" now widely available at these banks and offering Islamic financial products side by side with conventional ones[19]. This practice might have offered a tool for customer retention and service diversification. One the other hand pure Islamic banks like Meezan bank have established their identity to be ṣḥārīāḥ compliant banking entity. Such banks still need contemporary research and development endeavor to know public perception about their interaction with conventional and regulatory institutions. It is need of the

[17] Shahid et al., "Efficiencies Comparison of Islamic and Conventional Banks of Pakistan."
[18] Khan, Hassan, and Shahid, "Banking Behavior of Islamic Bank Customers in Bangladesh."
[19] Shahid et al., "Efficiencies Comparison of Islamic and Conventional Banks of Pakistan."

hour for sustainable growth and development in Islamic finance sector.

Some eminent Muslims scholars, known in literature as enthusiasts totally negate the idea of banking sector in an Islamic perspective[20]. They believe that idea of Islamic banking is nothing but a classical example of renaming the interest based business practices with a cover of Islam. They see no provision of banking institution in a Muslim society as historical institution of Bāīṭ ūl māll (Islamic State Exchequer) serves the purpose very well. They reject the need of maintaining surplus funds by private individuals and consider state as the only entrusted entity in this case.

Majority of Muslims thought about the existing system of Islamic banking that this system is a mere copy of conventional banking [21]. Now considering these researcher's views the customer's perception about interest factor in Islamic banking in Pakistan needs to be identified so the research gap is that what is the perception of customers about interest factor in Islamic banking in Pakistan.

2.4 Method

This research was conducted to find out customer's perception about interest factor in Islamic banking in Pakistan. Data was collected from one hundred respondents using a structured questionnaire method. The sample was selected randomly using judgmental sampling such that those respondents were selected who had their bank accounts in either conventional banks or Islamic banks or accounts in both banks of Pakistan.

3. Results and Discussion

This portion is about finding and analysis of the study. Initially it shows

[20] Hassan et al., "Measuring Customers Loyalty of Islamic Banking in Bahawalpur Region."
[21] Hanif, "Differences and Similarities in Islamic and Conventional Banking."

the findings of customer's perception about interest factor in Islamic banks. Further it describes the customer's perception in different and finally it shows the general customer awareness level about interest factor in Islamic banks.

3.1 Perception Index and Score

Table 1 shows that customer have almost similar perception about Islamic banks as that for conventional banks, that is, they consider that Islamic banks are similar to conventional banks.

Table 1: Customer's perception about interest factor in Islamic banks

N	Min	Max	Mean	Sig
100	1.14	5.00	2.9457	0.000

To check Customer's Perception about Interest Factor in Islamic Banks in Different Demographics, the awareness level was analyzed across different age groups, income groups and qualification groups. Analysis of Variance was applied to check whether perception about interest factor in Islamic banks significantly differ across these groups. The result was found insignificant which shows that all the research participants have the same perception that Islamic banks are not truly Islamic and according to ṣḥārīāḥ principles and the profit factor in Islamic banks is like interest factor in conventional banks.

Table 2: Customer's perception about interest factor in Islamic banks

	Mean Perception	Sig
Customer perception about interest factor in Islamic banks * Age	2.9457	0.997
Customer perception about interest factor in Islamic banks * Income	2.9457	0.400

Customer perception about interest factor in Islamic banks * Qualification	2.9457	0.748

To find out why customers have almost the same perception about interest factor in Islamic banks as like a commercial bank, a regression analysis was made between the 'General Awareness of the Customer and their Perception about Interest Factor in Islamic Banks'. The result found that awareness has a significant role in the formation of public perception about interest factor in Islamic banks to be Islamic or commercial bank.

Table3: Relationship between customer awareness and perception about interest factor in Islamic banks

Model	Sum of squares	Df	Mean square	F	Sig
Regression	2.135	1	2.135	4.922	.029
Residential	42.509	98	.434		
Total	44.644	99			

The result of regression analysis shows that awareness plays 22% role in the formation of customer's opinion about the Islamic or un-Islamic nature of Islamic banks in Pakistan.

Table4: Awareness level of the respondents about interest factor in Islamic banking in Pakistan

Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		

1	(Constant)	2.515	.205		12.271	.000
	I am aware of different schemes of Islamic banks	.129	.058	.219	2.219	.029

a. Dependent Variable: Customer's Perception About Interest Factor in Islamic Banks

3.2 Conclusion

Keeping in view the aim of the study and basic premise of analysis, it is evident that there are gross misperceptions and a deficit of trust, related to prevailing practices of Islamic banks. Though, the study takes into account a limited geographical area, results being quantitative in nature, to some extent qualify to be generalized. After the analysis of statistical data pertaining to seven questions regarding perceived Interest Factor in Islamic Banking in Pakistan, there is a clear trend of misperception. The SPSS data analysis (regression analysis) shows that both modes of banking, under investigation couldn't significantly be differentiated from each other. Respondents perceive profit factor in Islamic banks as similar to interest factor in conventional banks.

3.3 Suggestions

Academia has a strong role to play in mitigating misperceptions of potential and existing customers. Tertiary level educational institutions and business schools are mildly engaged in promoting degree programs in Islamic banking and finance. These efforts can create an impact of aspects of Islamic banking apart from religious reasons. New ideas to existing

practices of Islamic banking will be shared through educational efforts.

The lack of awareness about the operations of Islamic banks significantly affects customer's perception; hence the awareness level of customer needs to be increased through different channels. Institutions, cooperatives and banking fraternity can promote a healthy dialogue in society to answer questions arising in minds from time to time. Print, electronic and social media can spread the word through insightful academic and practical contributions.

Research and development plays a major role in keeping the financial performance at par with expectations and industry averages. Having dedicated research support may yield in performance augmenting ideas. The ultimate purpose should be ever increasing ṣḥārīāḥ compliance and confidence building of customers.

It is important to realize that there are dissenting voices within the contemporary Islamic scholars on the topic. It always keeps the theme of Islamic mode of financing more topical. There should be careful selection of products to be offered in a given market, keeping in view the popular fīqḥ following among the potential customers. Globally financial products of Islamic banking are offered in great variety. Various modes have varying acceptability and popularity among different segments. On such grounds ṣḥārīāḥ board in one country disallows some products that have already been launched without hesitation in other. Cooperation at board levels proved vital to promote greater understanding to ensure homogeneity and coherence. It is also high time for boards to have diverse representation. Members from religious quarters should equip themselves with contemporary corporate world. On other hand, corporate executives must have a learning attitude towards ṣḥārīāḥ clauses.

The main constraint is the shortage of time due to which the study was

conducted in one city of Khyber Pakhtunkhwa. Being a cross sectional study, varying tendencies of respondents, from conventional to Islamic banking or vice versa could not be recorded. It had to rely only on primary data. In future endeavors, a combination of both primary and secondary data would be more desirable. In future, the scope of the study may be extended to other areas of provinces as well.